

Track Group

Location tracking and analytics

Initiation of coverage

Tech hardware & equipment

5 May 2015

Price **US\$9.25**
Market cap **US\$93m**

Track Group is aiming to become a one-stop provider of tracking, monitoring and data analytics services with an initial focus on the global offender management market. The company's revenue is recurring in nature and near-term growth should be supported by the company's contract with Chilean Gendarmerie. The signing of other major national or state-scale contracts should accelerate growth, while the refinancing of debt should also be a key catalyst for upside.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	EV/EBITDA (x)	Yield (%)
09/13	15.6	(0.5)	(8.5)	0.0	34.9	N/A
09/14	12.3	(7.1)	(71.4)	0.0	N/A	N/A
09/15e	24.6	(0.7)	(6.7)	0.0	30.7	N/A
09/16e	32.8	7.5	74.0	0.0	8.1	N/A

Note: *PBT and EPS are normalised, excluding acquired intangible amortisation, exceptional items and share-based payments.

Tracking-as-a-service

Track Group's core business is based on the manufacture and leasing of devices to federal, state and local law enforcement agencies for the electronic monitoring of offenders. Penetration of electronic tagging in the global offender market is still low. Even in the US, the most advanced market globally, only a small proportion of the c 5m offenders under community supervision are currently electronically monitored. The drivers for increased adoption look very strong – the cost of tagging offenders has been estimated at c one-sixth of the cost of incarceration and jail occupancy rates are at high levels globally. Falling device costs combined with the potential added value of analytic services could accelerate adoption.

Recurring revenue model, margin expansion drivers

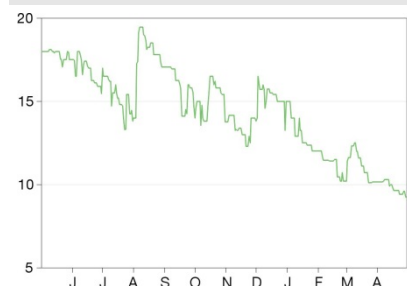
Devices are leased on a per-day, per-active-device basis giving the company a recurring revenue model. Our revenue growth estimates for FY15 (100%) and FY16 (33%) are driven primarily by the Chilean contract, which drives the number of tags in use from 8k exiting FY14 to 15k exiting FY16. Through the acquisition of G2 research, we believe that Track Group is also the only company among its direct peers offering analytics services, which could become a key differentiator. Uptake of analytics should also drive further gross margin expansion, although this is still at an early stage and therefore not yet included in our forecasts.

Valuation: Geographic and vertical expansion is key

Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.5% to c \$100m in 2025 with EBITDA margins reaching 25% at this time. To put this into context, we believe this could be achieved through securing three or four significant contracts similar in size to Chile over the next 10 years. The securing of further national/state-wide deals are therefore a key catalyst, in that they could put Track Group ahead of this growth curve and further improve commercial credentials. Our forecasts assume the \$30m of debt that matures over the next 12 months will be refinanced.

Net debt (\$m) at 31 December 2014	25.1
Shares in issue	10.1m
Free float	28%
Code	SCRA
Primary exchange	OTCBB
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.9)	(23.0)	(48.1)
Rel (local)	(9.6)	(26.3)	(53.1)
52-week high/low	US\$19.45	US\$9.25	

Business description

Track Group develops and provides end-to-end B2B and B2G tracking solutions that combine real-time tracking devices and monitoring services with advanced data analytics for the global offender management market. However, healthcare monitoring, asset tracking and data analytics are key opportunities for growth.

Next event

Q215 report	May 2015
-------------	----------

Analysts

Tom Grady	+44 (0)20 3077 5767
Katherine Thompson	+44 (0)20 3077 5730

tmt@edisongroup.com

[Edison profile page](#)

Investment summary

Company description: Electronic monitoring

Track Group offers a patented portfolio of tracking devices, monitoring services and data analytics capabilities to the offender management market and is looking to expand into healthcare, insurance and logistics. In March 2014, it acquired GPS Global, an Israeli start-up with advanced electronic monitoring technology and tracking platform, which was rolled out globally in late 2014. In June 2014 it acquired Emerge Monitoring, which provided a strong customer base and real-time alcohol monitoring technology. In November 2014, Track Group then acquired G2 Research, which has device-agnostic analytics capabilities that could become an important additional revenue stream.

Financials: High-retention recurring revenue

Electronic monitoring devices are typically leased to customers on a per-day basis. The daily rate ranges from \$2 to \$15 per day depending on the types of services offered and devices used. The revenue stream is recurring with a current churn rate of less than 8% in terms of the number of devices being returned each year. Historic gross margins have been c 50%, but the new generation of device and the provision of analytics services could increase this significantly. In September 2014 Track Group began installing devices for the Chilean Government that could generate revenues of up to \$70m over 41 months which combined with the acquisitions will drive much of the 100% forecast growth in revenues in FY15 and 33% in FY16. The Cash at 31 December 2014 was \$5.2m and debt was \$30.3m, most of which will need to be refinanced over the coming year.

Sensitivities: Government budget constraints drive demand

Funding: Track Group has \$30m of debt that matures over the next year; additional funding will be required for Track Group to continue as a going concern but management is confident that the debt will be refinanced without difficulty. **Major deals:** Signing further significant deals such as the Chilean contract could significantly boost revenue. We understand from management that there are a number of substantial contracts coming up for tender over the next few years, and so if Track Group can win some of these contracts it could prove transformational for the business.

Competition: electronic monitoring of offenders is a competitive industry and therefore daily monitoring rates could come under pressure. Track Group has tried to mitigate this by investing in innovative and patented technology and maintaining investment in R&D so that it can provide leading technology, but at a competitive price. **Chilean contract:** Track Group has signed a substantial contract with Chile. While the contract is currently being delivered – and there are no indications that it will fall through – contract failure could materially affect the group's results.

Liquidity and large shareholding: Track Group's free float is 28%, with more than 50% of shares controlled by a single shareholder.

Valuation: Geographic and vertical expansion key to valuation

If Track Group can follow up the Chilean contract by securing further state or nationwide deals, we believe there is clear potential to drive upside. The opportunity for electronic monitoring of offenders is clearly substantial and there is further potential in other verticals such as healthcare and logistics, although the pace of growth and ultimate potential market size is difficult to quantify. Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.5% to c \$100m in 2025 with EBITDA margins reaching 25% at this time. At a daily lease rate of \$7.50 this would represent c 55k devices in use for 250 days per year, which could be achieved through rolling out and retaining only three or four significant contracts similar in volume size to Chile over the next 10 years. Track Group currently has an installed base of 8,000 tags, and 100,000 offenders are being electronically monitored in the US, with another 100,000 in the UK.

Company description: Electronic monitoring

Track Group provides a range of tracking and analytics services to a range of verticals, but most revenue currently comes from offender monitoring. Most revenue is from the US, South America, and the Caribbean, where devices and associated services are leased on a per-day basis. It therefore has a high degree of recurring revenue. It is also trying to grow into the analytics space where it can use device-agnostic tracking data to provide insightful analysis to its customers. This is a significant potential value-added growth area.

Company history

Track Group was formed from the combination of SecureAlert, GPS Global, Emerge Monitoring and G2 Research. SecureAlert was the original listed entity and acquired GPS Global for \$7.8m (\$7.5m shares, \$0.3m cash) in March 2014, Emerge Monitoring for \$7.4m cash in June 2014 and G2 Research for C\$4.6m (C\$2.0m cash, C\$2.6m equity earnout) in November 2014. The company was renamed Track Group in October 2014.

Tracking and analytics service for a wider audience

Electronic monitoring is a competitive area. To differentiate itself Track Group is aiming to provide a package of services from which its customers can select on a platform-as-a-service (PaaS) basis. This includes the basic tracking devices, add-ons including an alcohol monitoring device, monitoring services and/or analytics services. The acquisitions of GPS Global and Emerge Monitoring are key parts of this strategy. The intention is that data collected through monitoring can be monetised through advanced analytics that can be sold as software-as-a-service (SaaS). G2 Research also provides device-agnostic analytics services, which are currently provided to law enforcement and national security agencies on an ad-hoc basis. The analytics services may also be developed to provide advanced warnings of crimes that may be committed by people on tags, based on their location and previous movements. This could be a key selling point for Track Group's devices and could help maintain daily lease rates and win new customers. Lowering the costs of manufacturing through subcontracting to Asian manufacture will help Track Group stay price competitive and improve its margins.

Management

Guy Dubois (chairman and co-CEO) was appointed director of SecureAlert on 3 December 2012 to oversee a restructuring of the business and the appointment of a new CEO. His appointment was a condition of a loan agreement SecureAlert signed with Sapinda Asia, a key shareholder. Guy is also a director and owner of Tetra House Pte, which provided SecureAlert with a \$25m credit facility in January 2014. Before SecureAlert, Guy was CEO of Gategroup AG from September 2008-11. During his tenure he oversaw the listing of the group on the SIX Swiss Exchange and saw the share price increase at over 45% CAGR from CHF15 in May 2009 to CHF45 in April 2011. The \$25m facility provided by Guy has since been securitised and sold on to investment trust Conrent Invest SA, which is also an equity investor in Track Group. David Boone is the acting CEO alongside Guy Dubois. He has had a number of senior roles in organisations such as Kraft, PepsiCo, Safeway and Belo Corporation. He also served as CEO of American CareSource Holdings and CFO of Intira Corporation. John Merrill was appointed CFO in April 2014. He has held a number of financial roles in organisations including UHG, Clear Channel, IMG, Sports Authority and CFO of Park City Group (NASDAQ: PCYG) a SaaS provider, and is therefore well placed to bring Track Group to the same standing.

Product description

Innovative tracking and alcohol monitoring technology

Exhibit 1 shows the list of products and services that Track Group currently provides. At the moment the products are mainly targeted at offender monitoring, but the intention is they this could be extended into a number of areas including monitoring for hikers and climbers, Alzheimer patients, children, cars/trucks and other physical property monitoring. Track Group intends to expand into these adjacent areas through B2B and B2G arrangement rather than direct to consumer, as it enables faster growth and a more secure revenue stream.

Exhibit 1: Product and service description

Product/service name	Product description
Shadow	Shadow is the device that was acquired with GPS Global. Management was attracted to the acquisition of GPS Global because it viewed the technology as the next generation of tracking device, liked its small form factor, the provision of both RF and GPS tracking and the fact that it can be automatically charged by the offender rather than needing to be replaced by the authorities. It requires limited intervention from Track Group's monitoring centre as events are typically dealt with by the law enforcement agency directly.
RADAR	RADAR was acquired with Emerge Monitoring and is an innovative and patented system for monitoring the alcohol levels of an offender. It is the most portable device available on the market. It uses biometric factors to identify the person using the device (ie heart rate, breath rate and lip print). It has real time reporting via the mobile network.
ReliAlert XC	ReliAlert XC is the original tag developed by SecureAlert. It has patented three-way communication technology, which allows the monitoring centre, offender and law enforcement offices to communicate. Most existing clients will be transitioned to the Shadow, which is lower cost and higher margin and does not require as much manual intervention by a monitoring centre and instead provides direct interaction between the law enforcement agency and the offender.
TrackerPAL	TrackerPAL is the tracking platform and gateway technology that allows law enforcement agencies to track the offenders in real time and manage the zones into which they are allowed to travel. It is available on desktop and mobiles and can be used across many different types of devices. TrackerPAL and the device-agnostic analytics could be a key route to Track Group improving growth and margins because it enables the company to penetrate the installed base of other device manufacturers if the law enforcement authorities deem their software to be more advanced.
Monitoring centres	Tags can either be monitored directly by the law enforcement agency or Track Group can provide that service. Track Group has a monitoring centre in Utah, US. Monitoring services are provided for an additional daily charge.
Device-agnostic analytics	Through the acquisition of G2 Research, Track Group now provides a range of proprietary analytics services for both electronic monitoring devices and any location-based information. This information could include information extracted from mobile phones or any devices that can track location. For the offender monitoring market Track Group is proposing that large-scale data analytics could be used to pre-empt offenders about to commit a crime, which would allow the authorities to intervene before anything actually occurs. The management and monitoring of the movements of offenders, irrespective of the device that is being used to track them, is also a key competitive advantage that few other companies are attempting to provide.

Source: Edison Investment Research, Track Group

Improving margins through outsourced manufacture

The legacy SecureAlert devices are manufactured in China and have a relatively high proportion of custom components. The new Shadow devices have a high proportion of pre-built components and the assembly and manufacturing costs are significantly lower. There are six major suppliers of components but currently only one manufacturer, although management is vetting a second service centre/provider to ensure stability of supply. There is generally an eight- to 12-week lead time with devices typically shipped straight to the customer. Management is confident that the quality control and reliability of the devices will be better than historic levels.

Personal, offender and asset tracking market

Track Group is currently focused on tracking offenders on community supervision orders, particularly in the US (74% FY14 revenue) the Caribbean (23%) and Chile (3%). However, the tracking technology has broader applications that could present additional growth opportunities in the medium to long term.

Offender monitoring market

There are no reliable global market figures available for the use of electronic monitoring, but several credible sources estimate that approximately 100,000 offenders are monitored each day in the US. To put this into context, the US Bureau of Justice Statistics states that 4.8 million offenders were under community supervision at the end of 2012, 851,000 of whom were on parole. The number of offenders under community supervision in the US fell marginally, by 0.85%, between 2012 and 2013, but only 2.1% of offenders under community supervision in the US are being electronically monitored so there is significant room for growth. There are no reliable statistics for the growth in electronic monitoring, but an estimated 4,914 offenders were being electronically monitored in 2007¹ compared to the current 100,000 estimate by BI, which implies a CAGR of 45%. Other jurisdictions electronically monitor a higher proportion of offenders under community supervision. In the UK, for example, between 2012 and 2013, there were 90,000 cases of individuals being electronically monitored, with approximately 24,000 being tagged at any one time. This is 58% of the c 154,000² offenders that were given community sentences in the 12-month period to September 2012. In the US, the Interstate Commission for Adult Offender Supervision (ICAOS) conducted a survey in 2007 on electronic monitoring usage in the US. A summary of the results is shown in Exhibit 2. Although the total number of offenders being electronically monitored will have changed significantly since then, there are no market share statistics available and the ranking of companies is likely to be broadly the same.

Exhibit 2: Summary of results from ICAOS GPS Survey 2007

Supplier	Number of states	Estimated number of offenders monitored at any one time
Satellite Tracking of People LLC (Securus)	2	1,351
ProTech (3M)	11	1,190
iSecureTrac (Corrisoft)	5	999
BI (The GEO group)	3	362
G4S	3	387
Sentinel Offender Service	3	310
Track Group	3	70
Other/not disclosed	3	245
Total	33	4,914

Source: ICAOS GPS Update survey April 2007

Political and social factors are the key drivers

Electronic monitoring reduces the number of offenders in prison and therefore lowers the cost to the state of monitoring and rehabilitating offenders. The US Department of Justice stated in 2011 that the cost of imprisonment to the state was six times higher than that of electronic monitoring. There is also some evidence to suggest that community supervision is also more effective at preventing reoffending. The Ministry of Justice in the UK, using 2011 figures, found that community sentences reduced one-year reoffending rates by 8.3% compared to custodial sentences for similar offenders. A study in Florida, commissioned by the US Department of Justice, also found that the risk of failure of community supervision was reduced by 31% as a result of electronic supervision. Despite this, however, there remain concerns about the safety of electronic monitoring, following instances of technological and administrative failures. This is likely to be holding back adoption in some jurisdictions, but with ongoing budgetary pressures and the large cost savings that can be made by moving towards electronic monitoring, it is likely that the long-term trend will be towards a higher number of more advanced electronic monitoring devices. The key growth driver for Track Group is likely to be more frequent monitoring of offenders on probation and parole, as well as monitoring offenders that would otherwise be sentenced to prison time. Therefore, although the overall prison

¹ ICAOS (Interstate Commission for Adult Offender Supervision) GPS Survey 2007.

² Ministry of Justice – Criminal justice statistics quarterly, September 2012.

population and community service sentences have been shrinking in some jurisdictions, the potential market for electronic monitoring could grow significantly.

Competitors

One-stop-shop for tracking everything

Track Group intends to build its competitive advantage by becoming a one-stop-shop for all tracking-related services including analytics. Currently the market is fragmented around each of the individual applications and none of Track's direct peers currently offer analytics services. The combination of Track Group's tracking platform, data analytics and globally distributed devices should act as an increasingly strong barrier to competition as more devices are deployed due to the virtuous circle of more data, improved analytics and higher value add. It is important however that its clients can effectively use the data to improve operational efficiencies or gain additional insight, which is currently unproven on a large scale. Exhibit 3 lists Track Group's key competitors in the offender monitoring space. There are a number of other competitors with personal tracking and asset monitoring, but given Track Group's low exposure to those areas at the moment, we have focused on the offender monitoring market.

Exhibit 3: Key competitors

Company name	Description
BI Inc (The GEO Group)	BI estimated as at January 2014 there were 100,000 offenders each day being monitored in the US, with 50,000 of them using BI devices. An additional 20,000 are monitored worldwide. BI has a wide range of products including RF, GPS, alcohol monitoring and monitoring centres. They use transdermal alcohol monitoring rather than breathalyser, which means alcohol can be detected using the tag itself (by monitoring alcohol levels in sweat) rather than a separate breathalyser. BI is a fully owned subsidiary of publicly listed GEO Group.
3M Electronic Monitoring	3M provides an extensive range of electronic monitoring solutions including some that are targeted for use with inmates rather than community supervision. 3M is an \$88bn NYSE-listed diversified technology company and therefore has significant resources to spend on the research and development of new monitoring solutions.
Satellite Tracking of People (STOP)	STOP was acquired by Securus on 20 December 2013. Securus provides technology and computer systems to 2,300 correctional facilities in the US, Canada and Mexico.
G4S	G4S claims to manage 12,000 offenders at any one time, although after losing its UK contract this number may have fallen significantly. The G4S system used in the UK was an RF-based home arrest system, which alerted local authorities when an offender went outside the range of the base station. It has since introduced GPS-enabled monitoring in Scotland.
Omnilink Systems	Omnilink was founded in 2004 with four employees and has grown to 65 employees today. It provides a wide range of solutions for tracking people and assets, eg people suffering from dementia, children, lone workers, vehicles, goods in transit and construction equipment. It has developed an M2M platform that enables applications to be developed quickly. Omnilink was purchased by Numerex Corp (NASDAQ: NMRX) in May 2014, a leading provider of on-demand and interactive M2M enterprise solutions.
iSecureTrac/Corrisoft	Acquired by Corrisoft on 17 December 2013, it provides a similar range of products to Track Group and operates in 41 states in the US and Canada. Corrisoft has developed a range of solutions for various levels of offender risk. All are based around its Air platform, which uses AIR Mobile – a proprietary smartphone that is equipped with GPS, geo-fencing and voice authentication technology – to provide additional resources to help offenders manage their rehabilitation. For high-risk offenders Corrisoft uses STOP's BluTag.
Sentinel Offender Services	Sentinel Offender Services provides GPS tracking, alcohol monitoring and various other products similar to Track Group. It claims to monitor up to 2,000 offenders per day. It also provides a range of probation and court services.
Buddi	Buddi is a small UK-based private company founded in 2005. It provides combined RF and GPS tracking tags that charge using the body's movement. Its system is used in Sweden, Canada, Ireland and New Zealand. It was awarded the contract for the tags and software to be used in the UK, but negotiations failed and the contract has since been awarded to 3M and Steatite. Despite its small size, Buddi has opened offices in the US and has hired Steve Chapin, who was a founder of ProTech Monitoring, which was sold to 3M in 2010. Therefore, although small in size, Buddi appears to be gaining a strong reputation in the industry and could be disruptive to incumbents.

Source: Edison Investment Research

Personal tracking

GPS Global, acquired by SecureAlert in March 2014, is an Israeli company that provides personal locating (as well as offender monitoring) devices that are used to track individuals in the general population. This type of device is marketed at parents who would like to be able to check where their child is, or security guards who could be tracked by a central office to ensure their safety. It is also marketed as a health monitoring device for people with health conditions such as dementia, who could benefit from having a mobile tracking device. Another potential use is for travellers and hikers who are travelling to remote areas and would like the ability to alert people and inform them of their location if they get into trouble. This is a relatively new area for Track Group and is quite a

competitive space, with a number of companies providing devices that can track children, dementia patients, pets or cars. To succeed in these areas it is likely that Track Group will need to adapt its current range of products to be more user friendly (eg can be worn on the wrist). The company may also require sales and marketing expenditure to make it stand out from its peers.

Vehicle and asset tracking

GPS Global also offers a vehicle tracking solution that can transmit audio, video and location over GSM/GPRS. It alerts the fleet/vehicle operator to speeding and can also be configured to send an alert if the driver enters or departs from a pre-defined area. The vehicle and asset tracking market is much bigger than the offender tracking market. ABI Research estimates the number of subscriptions to tracking services will grow from 13.3m in 2012 to 30.4m in 2016. In March 2012, Global Industry Analysts estimated the commercial vehicle telematics market will reach \$17.3bn by 2017. The industry is fragmented with numerous players developing proprietary solutions. However, most solutions just provide car and engine management data, but typically do not have the video transmission capabilities of GPS Global's solution. GPS Global is a minority player in the market, although integration within Track Group could help accelerate its growth.

Sensitivities

- **Funding:** Track group has \$30m of debt that matures over the next year; additional funding will be required for it to continue as a going concern.
- **Major deals:** Signing further significant deals such as the Chilean contract could significantly boost revenue. We understand from management that there are a number of substantial contracts coming up for tender over the next few years and so if Track Group can win some of these contracts it could prove transformational for the business.
- **Competition:** offender tracking is a competitive market, with some larger companies than Track Group operating in the space. This could make it difficult for Track Group to gain market share and maintain margins.
- **Chilean contract:** the Chilean contract is expected to be a significant proportion of FY15-16 earnings and therefore failure of this contract or termination after the contracted period could have a material impact on earnings.
- **Liquidity and large shareholding:** Track Group's free float is 28%, with over 50% of shares controlled by a single shareholder. This could lead to volatility in the share price or pricing pressure if the large shareholder decides to sell.

Financials

High-retention recurring revenue

Monitoring services are charged on a per-day, per-device basis, with services provided by peers ranging from \$1.50 to over \$25 a day³ depending on the devices provided and the services offered. A daily rate of c \$1.50 is charged for devices held by clients but not being used. Track Group currently has c 8,000 devices in operation (US 6,000, Chile 1,000, South America, Canada and the Caribbean 0.8k). Active devices are charged at a higher rate (\$5+ per device per day) to idle devices (\$1.50 per device per day) and management suggests that generally devices are used for 260 days each year. Generally, authorities are not required to use a minimum number of devices,

³ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Public-Sector/dttl-ps-publicsectordisrupted-08082013.pdf>.

but are only provided with the inventory that they are likely to use. Once an authority deploys a certain type of device it is typical that they will keep using that device for three to five years, which results in a stable underlying revenue stream for Track Group. Management reports that typically less than 8% of the existing installed based become inactive each year due to authorities reducing their monitoring schemes or switching providers. Within Track Group, the daily charge will vary depending on which device the customer chooses and whether they sign up for analytics and/or 24/7 monitoring by Track Group's service centre. We expect the average daily rate to be single-digit US\$ and fall over time as the device cost falls and the industry becomes more competitive. For the purposes of our model, we assume the average daily rate is \$6.30 currently, falling to \$5.60 per day by 2016 for the US market. This will be a blended rate across all services and products provided. Exhibit 4 shows our revenue assumptions based on estimates for devices in use and average daily rate charged to customers. Occasionally there are also one-off contracts that do not conform to the normal contract structure because additional services are provided such as advisory work or assistance in constructing effective monitoring centres that the customer will staff. We assume an 8% churn rate (on a device numbers basis) each year.

Exhibit 4: Revenue assumptions		
	2015e	2016e
Total number of tags in use at end of period	10,360	11,031
Proportion of tags lost/damaged/sold on	8%	8%
New tags introduced	3,000	1,500
Average lease revenue per day per tag (\$)	6.30	5.60
Alcohol monitoring units in use		1,000
Daily rate for alcohol monitoring (\$)		6.00
Lease days per year	260.00	260.00
One-off contracts with Chile/Mexico/Other (\$m)	6.0	12.5
Monitoring services lease revenue (\$m)	17.0	17.6
Total monitoring services revenue (\$m)	23.0	30.1
Product sales(\$m)	0.2	0.2
Analytics(\$m)	1.5	2.5
Total revenue (\$m)	24.6	32.8
Source: Edison Investment Research. Note: All figures are Edison estimates.		

Emerge Monitoring provides boost to installed base

The acquisition of EmERGE Monitoring for \$7.4m cash in June 2014 provided Track Group with its Real-Time Alcohol Detection and Recognition (R.A.D.A.R) system and an installed base of c 2,000 tracking units. Increasing the installed base and the number of authorities with which Track Group is working is an important growth strategy as it allows cross-selling of analytics, tracking and alcohol monitoring across all authorities. Our forecasts do not explicitly factor in any cross-sell, although it does represent a significant opportunity. In our forecasts we have assumed EmERGE's installed base is transferred to Track Group bringing the total installed base to c 10,000 units in 2015. We then assume an increase of 700 units in 2016 based on a growth rate (in units) of 6.4%. This does not include any major Chilean-sized contract wins.

Chilean contract: \$70m potential revenue over 41 months

A contract was signed with the Chilean prison service in November 2013 for up to 9,400 devices and up to \$70m revenue over 41 months. A \$3.4m performance bond was required and posted by Track Group as a condition of the contract and will be returned on successful completion. The \$70m maximum potential contract revenue assumes 100% utilisation of the 9,400 tags; we have been conservative in our forecasts and assumed only 1,900 devices are rolled out by the end of FY15, increasing to 4,000 by FY16 as the systems and process become more established.

Gross margins and operating expenses

The cost of operating devices is calculated on a cost-per-day basis. Track Group's legacy devices are comparatively high cost (c \$2-4 per day), but the new GPS Global devices cost around half that, with the opportunity for further reduction as production scales. This is achieved through GPS Global's device using mainly (85% of total) pre-built components. The transition of the installed base from the ReliAlert XC devices to GPS Global devices should therefore provide a substantial boost to gross margins even with a reduction in daily pricing. We model this as an improvement in gross margins for monitoring services to 65% in 2015 followed by a further increase to 70% in FY16. There is typically an eight- to 12-week lead time with the product shipped directly to the customer to minimise the storage and inventory costs. The high-margin analytics software could improve gross margins as it grows to be a greater proportion of total revenue. The main operating costs of the business are currently the monitoring centres, R&D and other staff costs. Sales and marketing are conducted at a senior level so marketing costs should not need to expand considerably. We expect overheads to fall as a result of the restructuring and movement to the new Shadow devices, which in conjunction with automation will require less monitoring centre capacity. Manufacturing is subcontracted to APS Technologies, which is a global contract manufacturer that has clients such as Sony, Dell, Panasonic and Tyco. There is limited capital investment required and low stock levels because stock is built as required by large contracts. Repair and maintenance of devices has historically been a fairly substantial cost, but the new devices and manufacturing process are expected to significantly reduce the repair and maintenance bill. R&D will continue to be an important expenditure as the technology is moving quickly and it is important that Track Group stays ahead of the competition from both a functionality and cost point of view.

Balance sheet and cash flow

Cash at the end of December 2014 was \$5.2m and there was \$30.3m of debt. \$24.6m of the debt relates to fixed 8% interest unsecured facility that is due to be repaid on 3 January 2016. A further \$2.6m relates to a royalty agreement with a third party, in which Track Group agreed to pay \$4.5m over two years for a non-exclusive, irrevocable, perpetual and royalty-free licence to use certain patents. An additional \$2.7m of related-party notes are payable over 2015. Refinancing these debts is crucial to the success of the business. There is c \$5m of contingent consideration payable in cash and shares that may become due depending on the performance of GPS Global and G2 Research, but we have not factored this into our forecasts.

Valuation

Significant regional and national contracts key to upside

If Track Group can follow up the Chilean contract by securing further state or nationwide deals, we believe there is clear potential to drive upside. The opportunity for electronic monitoring of offenders is clearly substantial and there is further potential in other verticals such as healthcare and logistics, although the pace of growth and ultimate potential market size is difficult to quantify. Given Track's comparatively early stage of development and the lack of direct peers, we believe that a reverse DCF provides the best gauge as to what the company needs to achieve to both justify its current valuation and drive further upside. Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.3% to c \$100m in 2025 with EBITDA margins reaching 25% at this time. To put this into context, at a daily lease rate of \$7.50 this would represent c 55k devices in use for 250 days per year which could be achieved through rolling-out and retaining only three or four significant contracts similar in volume size to Chile over the next 10 years. We have not incorporated the potential upside from the analytics business because it is too early to quantify the pace of growth. However, if a growth trend is clearly established over the coming quarters it could

warrant valuing as a separate component with valuation multiples closer to that of SaaS analytics companies, which typically trade at much higher multiples. Our DCF assumes a WACC of 10%, terminal growth of 3% and the average daily lease rate per device falling from c \$10 global average in 2015 to c \$7.5 in 2025. There is a high degree of uncertainty in these assumptions and therefore it is useful to look at a range of revenue growth rates and EBITDA margin, as shown in Exhibit 5. Exhibit 6 shows the corresponding revenue and tag count at the same growth rates. Exhibit 7 shows the sensitivity of the DCF valuation to WACC and revenue CAGR from 2015-25.

Exhibit 5: DCF sensitivity analysis

		Revenue CAGR 2015-25				
		12.3%	15.3%	18.7%	21.8%	25.0%
EBITDA Margin	25.0%	7.6	9.6	12.5	15.8	19.9
	30.0%	9.8	12.4	16.1	20.5	25.9
	35.0%	12.0	15.2	19.8	25.2	31.9

Source: Edison Investment Research. Note: Figures in table are DCF valuation per share (\$).

Exhibit 6: Terminal revenue and number of tags in operation by 2025

	12.3%	15.3%	18.7%	21.8%	25.0%
Terminal revenue (\$'000)	78,671	102,454	136,485	177,339	228,516
Number of tags in operation in 2025	41,958	54,642	72,792	94,581	121,875

Source: Edison Investment Research

Exhibit 7: WACC sensitivity

		Revenue CAGR 2015-25				
		12.3%	15.3%	18.7%	21.8%	25.0%
WACC	10.0%	7.6	9.6	12.5	15.8	19.9
	12.5%	5.1	6.5	8.4	10.5	13.2
	15.0%	3.7	4.6	6.0	7.5	9.4
	17.5%	2.7	3.4	4.4	5.6	6.9
	20.0%	2.0	2.6	3.3	4.2	5.3

Source: Edison Investment Research. Note: Figures in table are DCF valuation per share (\$).

Tag numbers in context

Management reports a number of jurisdictions worldwide that are opening up a tender for EM contracts. Two are reported by management to be for c 20-25,000 tags each with a number of other smaller opportunities. Winning significant national contracts such as these could provide an immediate boost to share price. Organic growth in its current geographies is also an important route for growth. This is likely to be primarily driven by Track Group winning market share. Expanding significantly into alternative applications could also result in substantial growth.

Premium to peers but limited insight from multiples analysis

Exhibit 8: Peer comparison

Company	Market cap (\$m)	FY15 EV/S	FY16 EV/S	FY15 EV/EBITDA	FY16 EV/EBITDA	FY15 P/E	FY16 P/E
Track Group	93	4.6x	3.3x	30.7x	8.1x	N/A	12.4x
3M Co	100,938	3.4x	3.3x	12.4x	11.7x	20.6x	18.7x
G4S	6,898	0.9x	0.8x	11.4x	10.5x	22.3x	19.1x
Trakm8 Holdings	51	1.7x	1.4x	12.7x	9.8x	18.9x	13.4x
Average		2.0x	1.9x	12.2x	10.7x	20.6x	17.1x

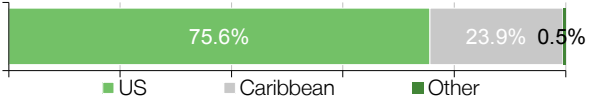
Source: Bloomberg, Edison Investment Research

We have also compared Track Group's valuation multiples against its peers in Exhibit 8. There are limitations in multiples analysis, as a result of the different sizes, target markets and stages of maturity of the businesses listed. 3M and G4S offer a wide range of products and services and therefore tracking is only a small proportion of the total. Trakm8 provides vehicle tracking and telematics, which is an area Track Group may get involved in, but is not the primary target market.

Exhibit 9: Financial summary

	\$'000s	2013	2014	2015e	2016e
30-September		US GAAP	US GAAP	US GAAP	US GAAP
PROFIT & LOSS					
Revenue		15,641	12,262	24,625	32,767
Cost of Sales		(8,030)	(5,499)	(8,405)	(11,376)
Gross Profit		7,611	6,763	16,220	21,390
EBITDA		2,966	(3,698)	3,674	13,433
Operating Profit (before amort. and except.)		552	(6,156)	974	9,133
Intangible Amortisation		(1,236)	0	0	(3,342)
Exceptionals		(1,150)	(1,592)	0	0
Other		549	(22)	0	0
Operating Profit		(1,286)	(7,770)	974	5,790
Net Interest		(1,094)	(922)	(1,653)	(1,653)
Profit Before Tax (norm)		(543)	(7,078)	(679)	7,479
Profit Before Tax (US GAAP)		(17,916)	(8,692)	(679)	4,137
Tax		0	0	0	0
Profit After Tax (norm)		(412)	(7,100)	(679)	7,479
Profit After Tax (US GAAP)		(17,916)	(8,692)	(679)	4,137
Average Number of Shares Outstanding (m)		4.8	10.0	10.1	10.1
EPS - normalised (c)		(8.5)	(71.4)	(6.7)	74.0
EPS - normalised and fully diluted (c)		(8.5)	(71.4)	(6.7)	74.0
EPS - (US GAAP) (c)		(370.8)	(87.4)	(6.7)	40.9
Dividend per share (c)		0.0	0.0	0.0	0.0
Gross Margin (%)		48.7	55.2	65.9	65.3
EBITDA Margin (%)		19.0	-30.2	14.9	41.0
Operating Margin (before GW and except.) (%)		3.5	-50.2	4.0	27.9
BALANCE SHEET					
Fixed Assets		17,167	37,096	37,940	35,684
Intangible Assets		15,414	33,321	30,955	27,613
Tangible Assets		1,754	3,775	6,985	8,072
Investments		0	0	0	0
Current Assets		9,532	17,364	13,116	19,194
Stocks		467	1,248	1,000	1,000
Debtors		5,506	5,014	6,421	8,139
Cash		3,382	11,102	5,696	10,056
Other		176	0	0	0
Current Liabilities		(2,695)	(9,400)	(10,352)	(10,294)
Creditors		(2,547)	(7,494)	(8,446)	(8,388)
Short term borrowings		(148)	(1,906)	(1,906)	(1,906)
Long Term Liabilities		(41)	(28,568)	(23,618)	(23,618)
Long term borrowings		(41)	(28,568)	(23,618)	(23,618)
Other long term liabilities		0	0	0	0
Net Assets		23,963	16,492	17,086	20,967
CASH FLOW					
Operating Cash Flow		1,933	(3,660)	4,741	8,315
Net Interest		(1,094)	(922)	(1,653)	(1,653)
Tax		0	0	0	(257)
Capex		(560)	(544)	(3,544)	(2,044)
Acquisitions/disposals		0	(12,293)	0	0
Financing		2,646	(218)	(4,950)	0
Dividends		0	0	0	0
Net Cash Flow		2,924	(17,637)	(5,406)	4,360
Opening net debt/(cash)		14,716	(3,194)	19,373	19,829
HP finance leases initiated		0	0	0	0
Other		14,986	(4,930)	4,950	0
Closing net debt/(cash)		(3,194)	19,373	19,829	15,469

Source: Edison Investment Research, Track Group

Contact details		Revenue by geography	
405 S. Main Street, Suite 700 Salt Lake City, UT 84111 US +1 866 451 6141 www.trackgrp.com			
CAGR metrics	Profitability metrics	Balance sheet metrics	Sensitivities evaluation
EPS 12-16e	N/A ROCE15e	2.7% Gearing 15e	116.1% Litigation/regulatory
EPS 14-16e	N/A Avg ROCE 12-16e	N/A Interest cover 15e	0.6 Pensions
EBITDA 12-16e	N/A ROE 15e	N/A CA/CL 15e	1.3 Currency
EBITDA 14-16e	N/A Gross margin 15e	65.9% Stock days 15e	14.8 Stock overhang
Sales 12-16e	25.7% Operating margin 15e	4.0% Debtor days 15e	95.2 Interest rates
Sales 14-16e	63.5% Gr mgn / Op mgn 15e3	16.7 Creditor days 15e	79.5 Oil/commodity prices
Management team			
Chairman and Co-CEO: Guy Dubois		CFO: John Merrill	
Guy Dubois was appointed director of SecureAlert on 3 December 2012 to oversee a restructuring of the business and the appointment of a new CEO. Before SecureAlert, he was CEO of Gategroup AG from September 2008-11. Over his tenure he oversaw the listing of the group on the SIX Swiss Exchange and saw the share price increase at over 45% CAGR from CHF15 in May 2009 to CHF45 in April 2011.		John Merrill was appointed CFO in April 2014. He has held a number of senior positions including as CFO of Park City Group (NASDAQ: PCYG) and Prescient Applied Intelligence, a Software-as-a-service provider of supply chain solutions. Between 2010 and 2013 John also worked as an advisor in the healthcare technology industry, where he advised on due diligence and integration of certain acquired companies.	
Co-CEO: David Boone			
David Boone is the acting CEO alongside Guy Dubois. He has had a number of senior roles in organisations such as Kraft General Foods, Sears, PepsiCo, Safeway and Belo Corporation. He also served as CEO of American CareSource Holdings and CFO of Intira Corporation.			
Principal shareholders			(%)
Sapinda Asia Limited			51%
Safety Invest			19%
All directors and executive officers			2%
Companies named in this report			
GEO Group (NYSE: GEO), 3M (NYSE: MMM), G4S (LSE:GFS)			

Edison, the investment intelligence firm, is the future of investor interaction with corporates. Our team of over 100 analysts and investment professionals work with leading companies, fund managers and investment banks worldwide to support their capital markets activity. We provide services to more than 400 retained corporate and investor clients from our offices in London, New York, Frankfurt, Sydney and Wellington. Edison is authorised and regulated by the Financial Conduct Authority (www.fsa.gov.uk/register/firmBasicDetails.do?sid=181584). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison and is not regulated by the Australian Securities and Investment Commission. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2015 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Track Group and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Aus and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2015. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.